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IN THE

Supreme Court of the United States

OCTOBER TERM, 1943.

No. 420

THE AMERICAN DISTILLING COMPANY,

Petitioner,

vs.

LOS ANGELES WAREHOUSE COMPANY,

Respondent.

ANSWER OF RESPONDENT TO PETITION FOR WRIT OF CERTIORARI

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Statement of the Case.

The statement of this case as set forth in the decision of the California Supreme Court [R. 165-167] may be accepted as a correct one inasmuch as Petitioner directs no criticism against it but contents itself with a challenge of the legal conclusions reached by both the majority and the minority opinions in Respondent's favor. Petitioner's summary and statement of the case appearing on page 2 of the Petition for Certiorari and adopted by reference on page 16 of the brief in support of the petition appears, however, to convey the impression Respondent was acting in this matter for San Angelo Corpora-

tion rather than for The American Distilling Company. Such was not the case. [R. 42-44, fols. 69-72, incl., and 47, fol. 77.] Petitioner was the *distiller* and the *owner* of the liquor, and it is nowhere claimed that San Angelo Corporation ever acquired any interest in the liquor whatsoever. Respondent had no dealings with San Angelo Corporation with respect to this lot of liquor.

The sole object of this proceeding is to place ultimate liability upon Respondent for the Government tax upon Petitioner's liquor in which Respondent had no interest whatever except as bailee.

It was in the capacity of distiller-owner that Petitioner enlisted the services of Respondent in attempting to consummate a sale to San Angelo Corporation. [R. 42-44.] Title to the liquor at all times prior to its destruction remained in Petitioner.

Rule 5 of Section 1739 of the California Civil Code provides:

> "If the contract to sell requires the seller to deliver the goods to the buyer, or at a particular place, or to pay the freight or cost of transportation to the buyer, or to a particular place, the property does not pass until the goods have been delivered to the buyer or reached the place agreed upon."

Petitioner had undertaken to pay the freight to Respondent's warehouse in Los Angeles and to deliver the goods at that point. [R. 42, fol. 70.]

The fundamental question here involved is not who as between the bailor (Petitioner) and bailee (Respondent) is liable in the *first* instance to the Government for the excise tax, but as between themselves, *both* having been liable to the Government, upon which one does the ulti-

mate liability fall? Respondent does not question its liability to the Government under its warehouse bond (a special contract). It does, however, challenge as revolutionary and unsupported by reason, or justice, the contention of Petitioner that it, a mere constructive custodian of the liquor without possessing the status of either distiller, or owner, of such liquor should be charged with liability for the tax without right of reimbursement from the distiller-owner.

ARGUMENT.

The Liquor Tax Is Not Imposed Upon a Mere Custodian, But Upon the Spirits Themselves.

Section 2800(a)(1) of the Internal Revenue Code* provides:

> "There shall be levied and collected *on all distilled spirits* (except brandy) in bond or produced in or imported into the United States an internal revenue tax at the rate of $2.25 (and on brandy at the rate of $2.00) on each proof gallon or wine gallon when below proof and a proportionate tax at a like rate on all fractional parts of such proof or wine gallon, *to be paid by the distiller* or importer *when withdrawn from bond.*" (Emphasis ours.)

Section 2800(c) of the Internal Revenue Code provides:

> "The tax shall attach *to distilled spirits,* spirits, alcohol or alcoholic spirit, within the meaning of subsection (b) of section 2809 *as soon as this substance is in existence as such,* whether it be subsequently

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*All references are to Chapter 26.

> separated as pure or impure spirit, or be immediately, or at any subsequent time, transferred into any other substance, either in the process of original production or by any subsequent process." (Emphasis ours.)

Section 2800(d) of the Internal Revenue Code provides as follows:

> "Every proprietor or possessor of, and every person in any manner interested in the use of, any still, distillery, or distilling apparatus, shall be *jointly and severally* liable for the taxes imposed by law *on the distilled spirits* produced therefrom." (Emphasis ours.)

Section 2800(e)(1) of the Internal Revenue Code establishes a lien as follows:

> "The tax shall be a first lien on the spirits distilled, the distillery used for distilling the same, the stills, vessels, fixtures, and tools therein, the lot or tract of land whereon the said distillery is situated, and on any building thereon from the time said spirits are in existence as such *until* (except as provided in paragraph (3)), *the said tax is paid.*" (Emphasis ours.)

There is nothing in any one of those provisions of the Internal Revenue Code which even suggests that a warehouseman as such is liable for the tax. His liability in so far as the Government is concerned springs from his special contract with the Government—his transportation and warehousing bond—required by paragraph 44, T. D. No. 4651, approved June 27, 1936. (Appendix to Petition P. X.)

The duty of the distiller to pay the tax is not extinguished by the warehousing bond but the warehousing bond is *cumulative* and *additional* security which the Government demands and receives whenever the distiller obtains a delay in the payment of the tax through the storing of the liquor in a bonded warehouse.

> *United States v. National Surety Co.,* 122 Fed. 904, 909-910;
>
> *United States v. Richardson,* 127 Fed. 893.

If the contention of Petitioner is correct, all a distiller or owner need do to shift the burden of the tax is to deposit the liquor in a bonded warehouse and such a deposit *ipso facto* relieve the distiller, or owner from further liability for the tax. Such an exemption was never contemplated by the law as clearly appears from the sections of the Internal Revenue Code above referred to and the cases cited. This unique contention made by Petitioner is commented upon by the decision in the District Court of Appeal in the following language [R. 163]:

> "If defendant is correct in its contention that as between it and the receiving warehouse the primary and ultimate responsibility is upon the receiving warehouse, and it, as between it and the receiving warehouse, is not liable, it would mean that a distiller-owner could store distilled spirits in the bonded warehouse of another and leave it there so stored for over eight years. The receiving warehouse would have to pay the tax at the end of eight years, and thereafter, if defendant is correct, the distiller-owner could remove the spirits from bond without paying or refunding the tax to the custodian warehouse. If

defendant is correct, the distiller would be completely and forever free from liability once the spirits passed into the hands of a bonded warehouse. That is not the law. (San Angelo, etc. v. S. End W. Co., 19 Cal. App. (2d) (Supp.) 749; American D. Co. v. Hollywood S. Co., 28 Cal. App. (2d) 439.)

From the above analysis it follows that as between the receiving warehouse and the distiller the ultimate and fundamental responsibility rests upon the distiller. The tax is not imposed on custody, but on the spirits themselves, and those spirits were distilled by defendant. When plaintiff paid the tax, as it was required to do, it was not paying its debt, but the debt of defendant. Plaintiff's primary responsibility to the government for the tax was simply the result of Congress' attempt to facilitate the administration of the tax provisions, and the collection of the tax. The liability is ultimately imposed on the distiller-owner, and not on the temporary custodian of the liquor."

We respectfully submit that the foregoing quotation is a correct interpretation of the law.

As Between Petitioner and Respondent the Petitioner's Liability Is Primary.

Section 2800(a)(1) and (d) of the Internal Revenue Code provides for this primary liability, and the following cases tend to support that proposition.

Germania Fire Ins. Co. v. Thompson, 95 U. S. 547, 24 L. Ed. 487;

Harkins v. Williard, 146 Fed. 703, 706;

Greenbrier Dist. Co. v. Johnson, 88 Fed. 638.

Also appropriate to the occasion is the language of this Court in the case of *Farrell v. United States,* 99 U. S. 221, 25 L. Ed. 321, where it is said, in holding the distiller liable for the tax:

> "Depositing distiller spirits in a government warehouse did not make them the property of the Government, or cause them to be held at the risk of the bailee. The property remained in the distiller, and the risk of loss by fire or any other casualty was, consequently, his."

The statement contained in the petition, at page 10, to the effect that the warehouseman assumed the obligation for the tax "as a condition to the privilege of operating as such" is clearly inconsistent, we think, with the cases of *United States v. National Surety Co., supra,* and *United States v. Richardson, supra,* holding that the warehousing bond does not extinguish the distiller's debt but that it is additional and cumulative security for the payment of that debt.

Another unsound premise relied upon by Petitioner is found on page 10 of its petition where it states:

> "The *owner* cannot obtain possession without payment of the tax. It is, however, quite a different matter to be obliged to pay the tax without getting the liquor." (Emphasis of the word "owner" ours.)

The destruction of the liquor in the case at bar was tantamount to its removal from bond by its owner. Such was the effect of the decision of the California Supreme Court [R. 169, fol. 255] and it finds support in *Farrell v. United States,* 99 U. S. 221, 25 L. Ed. 321, where the Court determined that the destruction of the liquor by a fire in a bonded warehouse was a removal of the liquor

therefrom and the tax had to be paid by the distiller and owner. Section 2800(a)(1) of the Internal Revenue Code states that the tax shall be paid by the *distiller* when the liquor is withdrawn from bond. Here the distiller and owner are one and the same.

We, therefore, do not think it a misconception of the law to assert that the last above mentioned quotation from the petition really amounts to a confession by Petitioner that the owner is liable for the tax, and should be compelled to pay it to Respondent here.

None of the Four Errors Specified in the Brief of Petitioner Is Tenable.

We find on page 16 of the petition and brief in support thereof the alleged errors claimed by Petitioner, the first of which is that the California Supreme Court erred in holding the federal tax on distilled spirits to be a property tax.

Some confusion appears to have arisen in the mind of Petitioner as to the sense in which the majority opinion of the California Supreme Court has used the expression following [R. 169]:

> "So far as persons dealing with the liquor are concerned the tax follows the property as a necessarily included part of the value thereof"

suggested, perhaps, by what is said in the minority opinion [R. 169-170]. It appears to us that the majority opinion has construed the liquor tax in the sense that this Court construed the tobacco tax in *Patton v. Brady,* 184 U. S. 608, 46 L. Ed. 719, where it is said:

> "it is not a tax on property as such, but upon certain kinds of property, having reference to their origin and their intended use,"

and in harmony with the case of *Hedger v. Union Ins Co.,* 17 Fed. 498, 499, where the Court held the entire value of the whiskey included the tax thereon.

Section 2800(a)(1), (b)(2), (c), (d), and (e)(1) of the Internal Revenue Code all indicate quite clearly, we think, that the tax is on the *goods* themselves, and Section 2800(e)(1) specifically provides that the tax shall be a first lien upon the spirits distilled from the time they come into existence, as such, until the tax is paid without exception. The tax thus follows the property, as the majority opinion holds, and the value of the owner's interest in the liquor is made up of the liquor as such plus the amount of the tax.

The second specification of error is that the California Supreme Court erred in holding the owner personally liable for the payment of the tax as an incident of ownership. What the court really said was that it becomes an obligation of the owner as an incident of ownership to pay the tax on removal from bond. [R. 169.] In effect Petitioner conceded this to be true when it said, on page 10 of the petition:

> "The owner cannot obtain possession without payment of the tax."

Petitioner advances no reason why a bailee-warehouseman should pay the tax except that it is a burden he assumes for the privilege of doing business as such, which is contrary to the holding in *United States v. National Surety Co., supra,* stating the warehousing bond is given as additional security only, does not extinguish the distiller's obligation to pay the tax and is required and given pursuant the Government's comprehensive system of administration and collection of liquor taxes. No statute

or other authority is cited to the effect that a stranger to the title or manufacture of distilled spirits is liable for the tax except in the instance of the bonded warehouseman who gives additional security in the form of his transportation and warehousing bond and thereby assumes liability under a special contract which is in no manner designed to relieve the distiller-owner in this case from the payment of his debt.

The third specification of error states the California Supreme Court erred in holding Petitioner-bailor liable to Respondent-bailee for the amount of the taxes advanced by the latter. The trial court found as follows [R. 47, fol. 77]:

> "That each and all of said sums so advanced and expended by the Plaintiff were paid out in pursuance of the authority and instructions of the Defendant given to the Plaintiff to bring about a transfer of said gin to Plaintiff's said warehouse in Los Angeles, California, and said payments were the direct consequence of acts done by Plaintiff at the direction of the Defendant and were in each instance paid in Defendant's behalf and for Defendant's benefit."

and as follows [R. 48, fol. 79]:

> "It is true that within two (2) years last past, in the County of Los Angeles, State of California, at the special instance and request of the Defendant, the Plaintiff furnished and paid out to and for the use and benefit of Defendant the sum of five thousand fifteen and 14/100 ($5,015.14) dollars which Defendant then and there impliedly agreed to repay to plaintiff on demand with legal interest."

As a basis of Respondent's right of recovery against Petitioner we cite Section 27 of Act 9059, 2 Deering's General Laws, 1937, page 4218, which provides:

> "Subject to the provisions of section 30, a warehouseman shall have a lien on goods deposited by the owner or by the legal possessor of the property or on the proceeds thereof in his hands, for all lawful charges for storage and preservation of the goods, also for all lawful claims for money advanced, interest, insurance, transportation, labor, weighing, coopering and other charges and expenses in relation to such goods; also for all reasonable charges and expenses for notice, and advertisements of sale, and for sale of the goods where default has been made in satisfying the warehouseman's lien."

California Civil Code, Section 1856, similarly provides:

> "A depositary for hire has a lien for storage charges and for advances and insurance incurred at the request of the bailor, and for money necessarily expended in and about the care, preservation and keeping of the property stored, and he also has a lien for money advanced at the request of the bailor, to discharge a prior lien, and for the expenses of a sale where default has been made in satisfying a valid lien. The rights of the depositary for hire to such lien are regulated by the title on liens."

In the case of *San Angelo Wine & Spirits Corp. v. South End Warehouse Co.,* 19 Cal. App. (2d) (Supp.) 749, it was held that a warehouseman had a lien upon the liquor concerning which he had paid the excise taxes.

See also:

> *American Dist. Co. v. Hollywood Storage Co.,* 28 Cal. App. (2d) 439, 82 P. (2d) 711.

In the case at bar Respondent could not assert a lien against the liquor since it was destroyed, but Section 32 of Act 9059, 2 Deering's General Laws, 1937, page 4218, provides:

> "Whether a warehouseman has or has not a lien upon the goods, he is entitled to all remedies allowed by law to a creditor against his debtor, for the collection from the depositor of all charges and advances which the depositor has expressly or impliedly contracted with the warehouseman to pay."

The correctness of the decision of the California Supreme Court in view of the foregoing authorities is unchallengeable, we think.

Under the authorities heretofore cited it sufficiently appears that it was the debt of The American Distilling Company that was paid by Los Angeles Warehouse Company and under the state law the latter was entitled to reimbursement.

The fourth and last specification of error is to the effect that the California Supreme Court erred in holding Petitioner liable to Respondent for the *amount* of the liquor excise taxes.

Here again the short answer to that purported criticism is that it was Petitioner's debt as distiller-owner, in the final analysis, which was paid by Respondent and Respondent was entitled to recover for the aggregate of the amounts it had advanced in behalf of and for the benefit of Petitioner upon the authorities cited in both the majority and minority opinions of the California Supreme Court, and for the reasons therein and herein stated.

Petitioner's Contention That the California Supreme Court Decision Is in Conflict With Federal Laws Is Untenable and No Federal Question Is Here Involved.

It is argued by Petitioner on page 21 of its brief in support of the petition that Treasury Decision 20, 290, and the two cases of *United States v. National Surety Co.*, 122 Fed. 904, and *United States v. Guest,* 143 Fed. 456, conflict with the California Court's decision, but that cannot be true because no such question as here concerns us was involved in either of those cases or discussed in the Treasury Decision referred to. In each and all of those cited instances the Government's legal rights were discussed and decided in controversies between the Government on the one hand and the taxpayer on the other No question was there involved as to the ultimate liability between a distiller-owner and a warehouseman. Such a question is not the concern of the Government, and it does not presume to define nor determine the respective rights and liabilities of those two parties. Such a question involves state law alone, does not present a federal question, and must be resolved in the light of state statutes and decisions, and that is what the California courts have done.

Petitioner argued his theory of applicability of the *National Surety Company* case, *supra,* and the *Guest* case, *supra,* as well as Treasury Decision No. 20290, to both the California District Court of Appeal and the Supreme Court of California and in each without avail simply be-

cause the correct analyses of those two federal cases and the Treasury Decision reveal their applicable limitations to the policy and rights of the Government in proceedings instituted *by the Government* for the collection of excise taxes on spirits due the Government only.

We therefore disagree with the statement contained on page 8 of the petition that a state court has decided a federal question of substance not theretofore determined by this Court, and assert that what the state court really decided was a question of ultimate liability as between two citizens of the State of California, one a bailor, and the other a bailee, both of whom were primarily liable to the Government for an excise liquor tax, and which tax the Government had proceeded to collect from the bailee in pursuance of its plan to facilitate the administration of internal revenue tax provisions and the collection of the tax.

The federal laws and regulations governing the imposition and the method of the collection of the tax do not determine the rights and liabilities of the parties to this litigation as between themselves once the tax has been paid.

The state law under such circumstances must be looked to and applied for such purposes, and that is what has been done in this case.

"The lack of substantiality in a federal question may appear either because it is obviously without merit or because its unsoundness so clearly results from the previous decisions of this court as to foreclose the subject." (*California Water Service Co. v. Redding,* 304 U. S. 252, 255.)

For the reasons hereinabove stated and because of the legal authorities herein cited it is contended by Respondent that the petition for a writ of certiorari to the Supreme Court of the State of California should be denied.

Dated at Los Angeles, California, October 30, 1943.

Respectfully submitted,

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